92-626

No. _____

Supreme Court, U.S.
FILED
OCT 13 1992
OFFICE OF THE CLERK

In The

Supreme Court of the United States

October Term, 1992

CATERPILLAR INC.,

Petitioner,

v.

MICHIGAN DEPARTMENT OF TREASURY,
REVENUE DIVISION,

Respondent.

**Petition For Writ Of Certiorari
To The Supreme Court Of
The State Of Michigan**

PETITION FOR WRIT OF CERTIORARI

RICHARD A. HANSON
Counsel of Record

DON S. HARNACK
GREGORY G. PALMER
CAROL S. PORTMAN
McDERMOTT, WILL & EMERY
227 W. Monroe Street
Chicago, Illinois 60606
(312) 372-2000

Of Counsel
OLIVER OLDMAN
Professor of Law
Harvard University
Langdell Hall
Cambridge, Massachusetts
02138

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
OR CALL COLLECT (402) 342-2831

QUESTIONS PRESENTED

1. Do the Capital Acquisition Deduction provisions of the Michigan Single Business Tax Act violate the Commerce Clause because they automatically provide a Michigan based company a larger tax benefit and a lower effective tax rate as compared to a non-Michigan based company such as Caterpillar when each acquires an identical piece of capital equipment?

2. Do the Capital Acquisition Deduction provisions of the Michigan Single Business Tax Act violate the Commerce Clause because they permit a deduction for the acquisition of real property located in Michigan but not real property located elsewhere?

3. Did this Court intend in *Trinova Corporation v. Michigan Department of Treasury*, ___ U.S. ___, 111 S.Ct. 818 (1991), to exempt from Commerce Clause challenge state tax provisions which "encourage the growth and development of intrastate commerce and industry" even when such provisions discriminate against out-of-state companies?

4. If this Court decides that the Capital Acquisition Deduction provisions unconstitutionally discriminate against Caterpillar, does the decision apply retrospectively?

TABLE OF CONTENTS

Page

QUESTIONS PRESENTED i

TABLE OF AUTHORITIES iii

OPINIONS BELOW 2

JURISDICTION 2

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED 3

STATEMENT OF THE CASE 3

REASONS FOR GRANTING THE PETITION 14

The Capital Acquisition Deduction Provisions Were Not At Issue In Trinova 15

The Capital Acquisition Deduction for Personal Property Favors Michigan Based Companies Solely Because of the Location of Their Business 16

The Capital Acquisition Deductions For Real Property Impermissibly Encourage Michigan Investment 21

This Court Should Clarify Its Decision In Trinova To Reaffirm That Discriminatory State Taxes Are Impermissible 23

This Court Should Reverse the Michigan Supreme Court and Apply its Decision Retrospectively 25

CONCLUSION 28

APPENDICES 1a

TABLE OF AUTHORITIES

Page

CASES:

American Trucking Associations, Inc. v. Scheiner, 483 U.S. 266 (1987) 17

American Trucking Associations, Inc. v. Smith, 496 U.S. 167 (1990) 26

Armco Inc. v. Hardesty, 467 U.S. 638 (1984) 27

Ashland Oil, Inc. v. Caryl, 497 U.S. 916 (1990).....27, 28

James B. Beam Distilling Company v. Georgia, ___ U.S. ___, 111 S.Ct. 2439 (1991) 26

Boston Stock Exchange v. State Tax Commission, 429 U.S. 318 (1977) ..... *passim*

Chevron Oil Co. v. Huson, 404 U.S. 97 (1971)...9, 26, 27

Halliburton Oil Well Cemeting Co. v. Reily, 373 U.S. 64, *reh'g denied*, 374 U.S. 858 (1963) 7

Kraft General Foods, Inc. v. Iowa Department of Revenue, ___ U.S. ___ 112 S.Ct. 2365 (1992) 12

McGoldrick v. Berwind-White Coal Mining Co., 309 U.S. 33 (1940) 23, 24

Mobil Oil Corp. v. Department of Treasury, 422 Mich. 473, 373 N.W.2d 730 (1985) 5, 22

Nippert v. Richmond, 327 U.S. 416 (1946)..... 24

Trinova Corp. v. Michigan Department of Treasury, ___ U.S. ___, 111 S.Ct. 818 (1991) ..... *passim*

U.S. v. Johnson, 457 U.S. 537 (1982).....26, 27

Westinghouse Electric Corp. v. Tully, 466 U.S. 388 (1984) ..... *passim*

TABLE OF AUTHORITIES – Continued

Page

CONSTITUTION AND STATUTES:

U.S. Const. Art. I, § 8, cl. 3 ..... *passim*

Mich. Compiled Laws, Ch. 208, M.C.L.A. § 208.23; M.S.A. § 7.558(23) ..... *passim*

Mich. Compiled Laws, Ch. 208, M.C.L.A. §§ 208.45, 46, 49, 51; M.S.A. §§ 7.558 (45), (46), (49), (51) ..... *passim*

OTHER AUTHORITIES:

Act of July 16, 1991, 1991 Mich. Pub. Acts 77 .. 3, 9, 15

H.B. 4640, 78th Legisl., Regular Session 1975 6

No. _____

In The

Supreme Court of the United States

October Term, 1992

CATERPILLAR INC.,

Petitioner,

v.

MICHIGAN DEPARTMENT OF TREASURY,
REVENUE DIVISION,

Respondent.

**Petition For Writ Of Certiorari
To The Supreme Court Of
The State Of Michigan**

PETITION FOR WRIT OF CERTIORARI

Petitioner, Caterpillar Inc. ("Caterpillar"),[1] respectfully prays that a writ of certiorari issue to review the opinion and judgment of the Michigan Supreme Court entered on July 31, 1992. In a four to three decision, the Michigan Supreme Court reversed the lower Michigan courts and upheld the Capital Acquisition Deduction provisions of the Michigan Single Business Tax Act against

[1] Petitioner has no parent company. Petitioner's subsidiaries (other than wholly-owned subsidiaries) are listed in the Appendix at 126a.

Caterpillar's claim that these provisions facially discriminate against Caterpillar in violation of the Commerce Clause of the United States Constitution.

OPINIONS BELOW

The majority and dissenting opinions of the Michigan Supreme Court are reported at 440 Mich. 400, ___ N.W.2d ___ (Mich. 1992) and are reprinted in the Appendix at 1a-92a.

The opinion of the Michigan Court of Appeals is reported at 188 Mich. App. 621, 470 N.W.2d 80 (Mich. App. 1990) and is reprinted in the Appendix at 93a-104a.

The Opinion and Order, Final Judgment in re Capital Acquisition Deduction, and Clarification of Final Judgment in re Capital Acquisition Deduction of the Michigan Court of Claims, Judge Thomas L. Brown presiding, are not reported. They are reprinted in the Appendix at 105a-115a.

JURISDICTION

The opinion and judgment of the Michigan Supreme Court was entered on July 31, 1992. No rehearing was requested. The jurisdiction of this Court to review the judgment of the Michigan Supreme Court is invoked under 28 U.S.C. § 1257(a).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

This case involves the following constitutional and statutory provisions:

U.S. Const. Art. I, § 8, cl. 3

Mich. Compiled Laws, Ch. 208, M.C.L.A. § 208.23(a); M.S.A. § 7.558 (23)(a)

Mich. Compiled Laws, Ch. 208, M.C.L.A. § 208.23(c); M.S.A. § 7.558 (23)(c)

Mich. Compiled Laws, Ch. 208, M.C.L.A. § 208.45, 46, 49, 51; M.S.A. § 7.558 (45), (46), (49), (51)

Act of July 16, 1991, 1991 Mich. Pub. Acts 77

The texts of these provisions are reprinted in the Appendix at 116a-121a.

STATEMENT OF THE CASE

This case involves Caterpillar's Commerce Clause challenge to the Capital Acquisition Deduction provisions of the Michigan Single Business Tax Act. The Single Business Tax uses different formulas to apportion the Single Business tax base and the deduction for the cost of capital assets. Caterpillar asserts that the use of these differing formulas facially discriminates in favor of Michigan based companies and against non-Michigan based companies in the same way as the New York statute which

this Court found unconstitutional in *Westinghouse Electric Corp. v. Tully*, 466 U.S. 388 (1984).[2]

Caterpillar

Caterpillar is incorporated in Delaware and headquartered in Peoria, Illinois. Caterpillar and its subsidiaries constitute the world's largest manufacturer of earthmoving, construction and materials handling equipment.

Caterpillar's facilities and employees are predominantly located in Illinois. Caterpillar conducts a portion of its business in Michigan and sells products to customers in Michigan. Caterpillar is subject to and pays Michigan Single Business Tax.

The Michigan Single Business Tax

The Michigan Single Business Tax is a modified value added tax. The tax is imposed on the value added to the economy by the taxpayer's business. Value added is

---

[2] Throughout this Petition Caterpillar refers to Michigan based companies and non-Michigan based companies. A "Michigan based" company is a company engaged in interstate business with a predominant part of its facilities and employees in Michigan as compared to its sales in Michigan. A "non-Michigan based" company is a company such as Caterpillar, engaged in interstate business with a predominant part of its facilities and employees outside of Michigan as compared to its sales in Michigan. The Michigan Supreme Court adopted these definitions for purposes of its opinion. Appendix at 3a, n. 4.

basically the sum of the taxpayer's net income, compensation, depreciation on capital assets, and interest expense.

The Single Business Tax uses the three-factor property, payroll and sales formula to determine the share of a company's value added tax base which is fairly apportioned to and taxable by Michigan.[3] The use of the three-factor formula to apportion the value added tax base was considered and upheld by this Court in *Trinova Corp. v. Michigan Department of Treasury*, ___ U.S. ___, 111 S.Ct. 818 (1991).

A major element of the Single Business Tax, which was not at issue in *Trinova*, is the Capital Acquisition Deduction. The Capital Acquisition Deduction provisions permit taxpayers to deduct, subject to certain limits, the cost of capital assets in the year the assets are acquired. In effect, the Single Business Tax allows a deduction for the "purchase price paid for the capital good - but then taxes its depreciation." *Mobil Oil Corp. v. Department of Treasury*, 422 Mich. 473, 373 N.W.2d 730, at 741, n. 14 (Mich. 1985). The Capital Acquisition Deduction is taken after the taxpayer has applied the three-factor formula to determine the portion of the value added tax base which is apportioned to and taxed by Michigan.

---

[3] The three-factor formula produces an apportionment percentage which is the average of three ratios: (1) Michigan property to total property, (2) Michigan payroll to total payroll, and (3) Michigan sales to total sales. See, *Trinova Corporation v. Michigan Department of Treasury*, ___ U.S. ___, 111 S.Ct. 818, 826 (1991).

The three-factor formula is not used to determine the deduction for the cost of capital assets. The Capital Acquisition Deduction for tangible personal property such as equipment is determined by multiplying the total cost of all equipment purchases, regardless of location, by a two-factor formula consisting of the taxpayer's property and payroll factors.[4] The deduction for real property such as buildings is limited to the cost of such property located in Michigan.

Proceedings Below

Caterpillar filed suit in the Michigan Court of Claims on December 10, 1984, requesting a refund of Single Business Tax for the tax year 1981. Caterpillar filed a second suit, for the tax years 1982, 1983 and 1984, on March 15, 1987. The cases were consolidated for trial and decision.

Caterpillar made two separate claims for relief. As one basis for relief, Caterpillar alleged that the three-factor formula overstated the amount of Caterpillar's value added tax base fairly apportioned to Michigan.

As a separate basis for relief, Caterpillar alleged that the Capital Acquisition Deduction provisions discriminated against Caterpillar in violation of the Commerce

---

[4] As originally proposed and as passed by both the Michigan House and Michigan Senate, the deduction for tangible personal property was to be determined using the three-factor property, payroll and sales formula. See H.B. 4640, 78th Legisl., Regular Session (1975). In the conference to reconcile the House and Senate versions of the Single Business Tax, the formula was changed to the two-factor formula.

Clause. Caterpillar alleged that the methods used to determine the allowable Capital Acquisition Deduction provided greater tax benefits and produced lower tax rates for Michigan based companies and Michigan investments solely because the companies and investments were located in Michigan. Caterpillar's discrimination claim relied primarily on this Court's decisions in *Westinghouse, Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318 (1977) and *Halliburton Oil Well Cementing Co. v. Reily*, 373 U.S. 64, *reh'g denied*, 374 U.S. 858 (1963).[5]

On July 13, 1989, the Court of Claims entered its Opinion and Order. The court declared that the Capital Acquisition Deduction provisions violated the Commerce Clause because the provisions impermissibly favored Michigan based companies over non-Michigan based companies. The court stated:

> The discriminatory effect of MCL 208.23; MSA 7.588(23) has been consistently ruled unconstitutional by the U.S. Supreme Court on grounds that it violates the commerce clause. In *Halliburton Oil Well Cementing Co. v. Reily*, 373 U.S. 64 (1962), reh'g denied, 374 U.S. 858 (1963), the U.S.

---

[5] Prior to a decision on Caterpillar's claims the Chief Judge of the Court of Claims issued an order holding in abeyance all cases involving challenges to the three-factor formula, pending final action in *Trinova*. Because the constitutionality of the Capital Acquisition Deduction provisions was a "separate issue" not present in *Trinova* and an issue "of great importance to the Department of Treasury and taxpayers", the parties filed a joint motion on November 10, 1988 requesting the Court of Claims to immediately consider and decide Caterpillar's constitutional claim. A copy of the Joint Motion is reprinted in the Appendix at 122a. Judge Brown granted the motion on November 16, 1988.

> Supreme Court struck down a Louisiana use tax exemption which had the effect of imposing a lower use tax on property assembled in Louisiana as compared to property assembled out of state and brought into Louisiana. The Court found this exemption to be a clear violation of the Commerce Clause because it discriminated against the out-of-state manufacturer as compared to the in-state manufacturer when each engaged in the same transaction – use of identical property in the state. The same result ensues here. A Michigan company receives a greater CAD than Plaintiff when each engages in the same transaction – purchase and use of an identical piece of property in Michigan.

Appendix at 107a. The Court of Claims also determined that its decision would be effective only for tax years beginning after September 30, 1989 and denied Caterpillar relief for the years 1981 - 1984. The Court of Claims further held that the discriminatory effect of the Capital Acquisition Deduction provisions should be remedied by severing those provisions from the statute.

Caterpillar appealed to the Michigan Court of Appeals those parts of Court of Claims' decision which denied retrospective relief and which eliminated the Capital Acquisition Deduction for future years. The Department of Treasury did not appeal any part of the Court of Claims decision. The Michigan Manufacturers Association was, however, permitted to file a brief *amicus curiae* to the Court of Appeals which argued that the Capital Acquisition Deduction provisions were constitutional.

The Michigan Court of Appeals issued its decision on February 5, 1991. The Court of Appeals affirmed the

Court of Claims' denial of retrospective relief. Citing *Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971), the Court of Appeals held that the Court of Claims decision was not clearly foreshadowed by prior decisions of this Court. The Court of Appeals reversed on the question of remedy, holding that only the language which discriminated against non-Michigan based companies should be severed from the statute.

On February 26, 1991, Caterpillar filed an Application for Leave to Appeal to the Michigan Supreme Court challenging only that part of the Court of Appeals decision which denied retrospective relief. On May 6, 1991, the Michigan Department of Treasury filed an Application for Leave to Appeal, challenging only that part of the Court of Appeals decision regarding the proper remedy for discrimination.

Prior to any action by the Michigan Supreme Court, the Michigan Legislature adopted and the Governor signed 1991 PA 77, which amended the Capital Acquisition Deduction provisions for tax years beginning after September 30, 1989. The amendment provided that the Capital Acquisition Deduction would be calculated by applying the three-factor formula to the cost of all capital assets.

On October 4, 1991, the Michigan Supreme Court instructed Caterpillar and the Department of Treasury to brief and argue the following issues: (1) Whether prior to

the passage of 1991 PA 77, the Capital Acquisition Deduction provisions violated the Commerce Clause;[6] and, if so, (2) whether the lower courts erred by limiting the effect of their rulings to tax years beginning after September 30, 1989; and (3) what relief, if any, Caterpillar should receive.

The decision of the Michigan Supreme Court was issued on July 31, 1992. The majority began its analysis of Caterpillar's discrimination claim by stating that a state tax violates the Commerce Clause if

> it is facially discriminatory, has a discriminatory purpose, *or* has the effect of unduly burdening interstate commerce.

Appendix at 22a (emphasis in original). In response to Caterpillar's claim of facial discrimination the majority stated:

> The CAD is available for any taxpayer, whether a multistate company or a company whose business activity is allocated entirely to Michigan – an instate company. This is true under both subsections 23(a) and 23(c). Therefore, Caterpillar cannot point to any treatment of instate and out-of-state companies that is discriminatory on its face.

---

[6] The Michigan Supreme Court held that it was authorized to consider the constitutionality of the Capital Acquisition Deduction provisions because of the importance of the issue. The Michigan Manufacturers Association again filed a brief *amicus curiae* in support of the constitutionality of the Capital Acquisition Deduction provisions.

Appendix at 22a-23a. On the questions of discriminatory purpose and effect the majority held that the Capital Acquisition Deduction provisions were fairly designed to measure the amount of taxpayers' Michigan investment and that Michigan was not required to use the same methods to apportion the value added tax base and the Capital Acquisition Deduction.

Finally, the majority interpreted this Court's decision in *Trinova* as having already considered and decided that the Single Business Tax, including the Capital Acquisition Deduction provisions, did not violate the Commerce Clause. The majority stated:

> Although the Court's analysis in *Trinova* was based on review of the SBT as a whole and not on the CAD provisions specifically, the Court expressly stated that the CAD provisions were relevant to the Court's analysis and review of the SBT's constitutionality. See *Trinova, supra,* 111 S.Ct. 826 and 835-836.

Appendix at 23a, n. 31. The majority then concluded:

> The *Trinova* Court found that the SBT did not discriminate against interstate commerce in violation of the Commerce Clause, distinguishing the SBT from other taxing statutes that it has held to be unconstitutional.

Appendix at 26a-27a. Having found that the Capital Acquisition Deduction provisions were constitutional the majority did not reach the questions of retrospective application and remedy.

Chief Justice Cavanaugh, joined by Justice Levin, dissented from the majority opinion.[7] He began by stating that *Trinova* did not address the constitutionality of the Capital Acquisition Deduction provisions:

> The majority appears to suggest that the United States Supreme Court may have already upheld the CAD apportionment against Commerce Clause challenge, as part of the overall scheme of the SBT, in *Trinova*. See slip op, p 23, n 31, and p 26, n 32. If this is what the majority intends to suggest, the suggestion is plainly erroneous.

Appendix at 32a, n. 3. Chief Justice Cavanaugh went on to conclude that the Capital Acquisition Deduction provisions were facially discriminatory, citing this Court's decisions in *Westinghouse; Boston Stock Exchange;* and *Kraft General Foods, Inc. v. Iowa Department of Revenue*, ___ U.S. ___, 112 S. Ct. 2365 (1992).

To illustrate the discriminatory effect of the two-factor formula, Chief Justice Cavanaugh used examples of hypothetical Michigan based and non-Michigan based companies similar to those used by this Court in *Westinghouse*. Appendix at 68a-71a. Based on these examples, Chief Justice Cavanaugh concluded:

> [I]t is clear, on the face of the statute, that two otherwise similarly situated companies that invest in equal-value amounts of new personal property during the tax year will receive different deductions under the CAD, depending on

---

[7] Justice Brickley filed a separate dissenting opinion in which he found the Capital Acquisition Deduction for tangible personal property to be unconstitutional under *Westinghouse* but the deduction for real property to be permissible.

> the degree to which they are physically based in Michigan to begin with (as measured by the property and payroll factors), *and* depending on whether they invest the newly acquired personal property in state or out of state.

Appendix at 49a (emphasis in original). Regarding the deduction for real property located in Michigan, Chief Justice Cavanaugh stated:

> [T]he deduction, resulting in a substantially lower effective tax rate on the Michigan-apportioned tax base, is afforded only to a company investing in Michigan real property, as compared to a similarly situated company investing in out-of-state real property.

Appendix at 52a. Chief Justice Cavanaugh summarized his analysis of the Capital Acquisition Deduction provisions as follows:

> Thus, both the personal property and real property CAD apportionment formulas, when applied in conjunction with the three-factor apportionment of the SBT itself, result in the imposition of higher effective tax rates on the Michigan-apportioned tax base with regard to companies that are either predominantly non-Michigan-based or that direct their investments outside Michigan. . . .

Appendix at 53a.

Chief Justice Cavanaugh also challenged the majority's interpretation of this Court's decision in *Trinova* as holding that all promotion of investment in Michigan is constitutional. He stated:

> [B]ecause I believe my colleagues have misconstrued the United States Supreme Court's case law in this regard, I discuss this issue in some detail.
>
> *Trinova* would seem, at face value, to afford the greatest support to my colleagues' position. The Court there stated: "It is a laudatory goal in the design of a tax system to promote investment that will provide jobs and prosperity to the citizens of the taxing state. States are free to 'structur[e] their tax systems to encourage the growth and development of intrastate commerce and industry.' " 112 L Ed 2d 912, quoting *Boston Stock Exchange*, 429 U.S. 336. Such sweeping language, if taken out of context and in isolation, would seem to flash a green light to economic protectionism. But this language can only be understood in context.

Appendix at 36a-37a. He argued that the Court's statement was made only in response to the taxpayer's claim in *Trinova* that encouragement of intrastate business was itself evidence of discrimination. Chief Justice Cavanaugh concluded that this language did not immunize the Capital Acquisition Deduction provisions from Commerce Clause challenge simply because they encourage Michigan business.

Caterpillar now petitions for a writ of certiorari to review the Michigan Supreme Court's decision.

REASONS FOR GRANTING THE PETITION

A writ of certiorari should be issued to review the decision of the Michigan Supreme Court because the

decision directly conflicts with this Court's decisions regarding discriminatory state taxes, particularly *Westinghouse* and *Boston Stock Exchange*. It is also important that this Court review and repudiate the majority's suggestion that *Trinova* approved the enactment of state tax provisions designed to encourage Michigan business regardless of their discriminatory impact. As Chief Justice Cavanaugh recognized, if the Michigan Supreme Court's misinterpretation of *Trinova* is not corrected, states may be encouraged to adopt protectionist tax legislation under the guise of encouraging intrastate business.

The Capital Acquisition Deduction Provisions Were Not At Issue In Trinova

The majority's suggestion that this Court considered and approved the Capital Acquisition Deduction provisions in *Trinova* is, as the dissent states, "plainly erroneous". These provisions are referred to only three times in the *Trinova* opinion and then only in describing the calculation of the taxpayer's Single Business Tax liability. See 111 S.Ct. at 826, 827 and 833. It distorts these brief references beyond recognition to suggest that the Court considered the constitutional status of the Capital Acquisition Deduction provisions. The majority's attempt to do so only highlights the weakness of its argument.[8]

---

[8] It is instructive that the Michigan Department of Treasury was apparently persuaded that the Capital Acquisition Deduction provisions were unconstitutional and, thus, did not appeal the Court of Claims decision. The Michigan legislature apparently reached the same conclusion and enacted 1991 PA 77 to change the method of calculating the Capital Acquisition

The Capital Acquisition Deduction for Personal Property Favors Michigan Based Companies Solely Because of the Location of Their Business

The inevitable effects of using a two-factor property and payroll formula to determine the Capital Acquisition Deduction for personal property are undisputed. They are illustrated by Chief Justice Cavanaugh's hypothetical taxpayers. Appendix at 68a-71a. The majority made no effort to challenge or rebut his analysis.

The hypotheticals involve two companies of identical size, with identical Michigan three-factor apportionment percentages and making identical investments. The use of the two-factor formula to determine the Capital Acquisition Deduction for tangible personal property gives the Michigan based company a substantially greater deduction than a non-Michigan based company when each invests in an identical piece of equipment in Michigan. Similarly, the use of the two-factor formula provides the Michigan based company with a lower effective tax rate than the non-Michigan based company. The greater tax benefit and lower effective tax rate are provided to the Michigan based company solely because its business is located in Michigan and for no other reason.

Even Chief Justice Cavanaugh overlooks the most pernicious effect of the method used to calculate the Capital Acquisition Deduction for personal property. Under his example the Michigan based company receives a Capital Acquisition Deduction of $68,233 where it invests $100,000 in equipment for use *outside* Michigan.

Deduction to one utilizing the three-factor formula. That action came after this Court's decision in *Trinova*.

Appendix at 70a. The non-Michigan based company receives a $31,667 Capital Acquisition Deduction when it invests $100,000 on equipment for use *inside* Michigan. Appendix at 68a. Thus, the Michigan based company receives a greater Capital Acquisition Deduction for investing outside Michigan than the non-Michigan based company receives for investing inside Michigan.

State tax provisions which discriminate based solely on the location of the taxpayer's business have repeatedly been held unconstitutional by this Court. *American Trucking Associations, Inc. v. Scheiner*, 483 U.S. 266 (1987), summarizes the Court's decisions as follows:

> Under our consistent course of decisions in recent years a state tax that favors in-state business over out-of-state business for no other reason than the location of its business is prohibited by the Commerce Clause. *Tyler Pipe Industries, Inc. v. Washington Dept. of Revenue, ante*, p. 232; *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984); *Armco Inc. v. Hardesty*, 467 U.S. 638 (1984); *Westinghouse Electric Corp. v. Tully*, 466 U.S. 388 (1984); *Maryland v. Louisiana*, 451 U.S. 725 (1981); *Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. 318 (1977).

483 U.S. at 286. *Westinghouse* illustrates the analysis which this Court has used to test state taxes against discrimination claims.

Westinghouse involved a challenge to New York's method of calculating a credit against its franchise tax for shipments made by Domestic International Sales Corporations ("DISCs") through New York ports. Like the Single Business Tax, the New York franchise tax is

apportioned using a three-factor formula. Like the Capital Acquisition Deduction, the DISC credit was taken after the franchise tax base was apportioned. The DISC credit was based upon the percentage of exports through New York ports versus total exports. The higher the percentage of shipments through New York, the greater the credit.

The Court's opinion analyzed the effect of the DISC credit by constructing hypotheticals showing various percentages of shipments through New York. The hypotheticals established that taxpayers received greater tax benefits and lower effective tax rates as their level of shipments through New York increased. On these bases the method used to calculate the DISC credit was found to violate the Commerce Clause.

Chief Justice Cavanaugh's hypotheticals establish the same patterns. Taxpayers receive a greater Capital Acquisition Deduction and lower effective tax rates as their production activities are concentrated in Michigan.

Westinghouse is also instructive because New York tried to defend the DISC credit using the same arguments that the Michigan Supreme Court majority used in the present case. For example, the majority in this case claims that the method used to apportion the Capital Acquisition Deduction is fair. New York also claimed that the method used to determine the DISC credit was constitutionally acceptable. The Court responded:

> The Tax Commission's argument that New York employs a constitutionally acceptable allocation formula, in our view, serves only to obscure the

> issue in this case. The acceptability of the allocation formula employed by the State of New York is not relevant to the question before us.

466 U.S. at 398. The same response is appropriate here.

The majority in this case takes comfort in the fact that this Court approved the use of the three-factor formula to apportion the Single Business Tax base and infers that this approval extends to the Capital Acquisition Deduction provisions. New York similarly argued that the Court's approval of the three-factor formula to apportion DISC income should be viewed as approval of the DISC credit. The Court in *Westinghouse* responded that the taxpayer's

> challenge is not foreclosed by our holding that New York's allocation of DISC income is constitutionally acceptable. See 459 U.S. 1144 (1983) (dismissing for want of a substantial federal question Westinghouse's challenge to method of allocating DISC income to parent). "Fairly apportioned" and "nondiscriminatory" are not synonymous terms.

466 U.S. at 399. The same response is appropriate here.

The majority argues that the Capital Acquisition Deduction provisions are intended only to limit the deduction to capital investments taxable in Michigan. New York argued that the limitation on the DISC credit was intended to ensure that the credit was available only for activities taxable by New York. In *Westinghouse* the Court responded:

> The Tax Commission argues that multiplying the allowable credit by the New York export ratio of the DISC merely ensures that the State is

> not allowing a parent corporation to claim a tax credit with respect to DISC income that is not taxable by the State of New York. This argument ignores the fact that the percentage of the DISC's accumulated income that is subject to New York franchise tax is determined by the parent's business allocation percentage, not by the export ratio. In computing the allowable credit, the statute requires the parent to factor in its business allocation percentage. § 210.13(a). This procedure alleviates the State's fears that it will be overly generous with its tax credit, for once the adjustment of multiplying the allowable DISC export credit by the parent's business allocation percentage has been accomplished, the tax credit has been fairly apportioned to apply only to the amount of the accumulated DISC income taxable to New York. From the standpoint of fair apportionment of the credit, the additional adjustment of the credit to reflect the DISC's New York export ratio is both inaccurate and duplicative.

466 U.S. at 399. The same response is appropriate here.[9]

---

[9] One other defense offered by the majority deserves comment. The majority suggests that the two-factor formula was chosen because the acquisition of capital assets "is most likely to be located where a company's property and payroll (employees) are located." No empirical support is offered for this statement. Moreover, if the statement is true, why did Michigan adopt a provision which disproportionately benefits Michigan based companies if they would place new investments in Michigan in any case? Caterpillar respectfully suggests that the answer is that the two-factor formula was chosen precisely because it benefits Michigan based companies – to the detriment of companies such as Caterpillar.

In the end, *Westinghouse* rejected all of New York's defenses with an analysis very similar to that used by Chief Justice Cavanaugh:

> It is this second adjustment, made only to the credit and not to the base taxable income figure, that has the effect of treating differently parent corporations that are similarly situated in all respects except for the percentage of their DISCs' shipping activities conducted from New York. This adjustment has the effect of allowing a parent a greater tax credit on its accumulated DISC income as its subsidiary DISC moves a greater percentage of its shipping activities into the State of New York.

466 U.S. at 400-401. The Capital Acquisition Deduction has the same effect and the Court should come to the same conclusion here.

It is the use of one formula to determine the amount of value added activities in Michigan and a second and different formula to calculate the allowable Capital Acquisition Deduction for personal property which make that provision unconstitutional. The result is discrimination in favor of Michigan based companies solely because they are located in Michigan. Such discrimination is unconstitutional.

The Capital Acquisition Deductions For Real Property Impermissibly Encourage Michigan Investment

The majority and Justice Brickley claim that limiting the Capital Acquisition Deduction for real property to property located in Michigan is a constitutionally permissible way to encourage Michigan investment. They ignore

the interrelationship of the Capital Acquisition Deduction provisions and the depreciation element of the value added tax base.

As the Michigan Supreme Court recognized in *Mobil Oil*, the Single Business Tax permits an immediate write-off for capital assets and then taxes the depreciation of such assets. As the Michigan Supreme Court put it, the Single Business Tax allows a deduction for the

> purchase price paid for the capital good – but then taxes its depreciation.

373 N.W.2d at 741, n. 14. The effect of this combination can be seen in Chief Justice Cavanaugh's hypotheticals. Appendix at 68a-71a.

Each hypothetical taxpayer acquiring Michigan real property receives a 100% Capital Acquisition Deduction but pays Single Business Tax on only approximately 50% of the subsequent depreciation on the property which is included in the tax base. By contrast, each hypothetical taxpayer constructing an industrial building outside Michigan receives *no* Capital Acquisition Deduction but still pays Single Business Tax on approximately 50% of the subsequent depreciation included in the tax base. This is a powerful, and impermissible, tax advantage to building in Michigan.

In *Boston Stock Exchange* the issue was whether New York could encourage trade on New York stock exchanges by imposing a lower tax rate on transactions conducted wholly on the New York exchanges than the rate applied to transactions conducted partially outside New York.

The Court held that the New York law violated the Commerce Clause because it provided a direct commercial advantage to local business. The Court stated:

> The obvious effect of the tax is to extend a financial advantage to sales on the New York exchanges at the expense of the regional exchanges. Rather than "compensating" New York for a supposed competitive disadvantage resulting from § 270, the amendment forecloses tax-neutral decisions and creates both an advantage for the exchanges in New York and a discriminatory burden on commerce to its sister States.

429 U.S. at 331. The Capital Acquisition Deduction for real property has the same effect. By permitting a deduction for Michigan investment but not for out of state investment, the Capital Acquisition Deduction for real property unconstitutionally encourages taxpayers to locate their plants in Michigan to the detriment of other states.

This Court Should Clarify Its Decision In Trinova To Reaffirm That Discriminatory State Taxes Are Impermissible

This Court's role in policing discriminatory state taxes is based on a fundamental fact of political life – taxpayers have little political voice outside their home state. This lack of a political voice was recognized by Justice Stone in *McGoldrick v. Berwind-White Coal Mining Co.*, 309 U.S. 33 (1940). He explained the Court's rationale for striking discriminatory state taxes:

> Lying back of these decisions is the recognized danger that, to the extent the burden falls on economic interests without the state, it is not likely to be alleviated by those political restraints which are normally exerted on legislation where it affects adversely interests within the state.

309 U.S. at 46, n.2. Justice Rutledge made a similar point in *Nippert v. Richmond*, 327 U.S. 416 (1946):

> Provincial interests and local political power are at their maximum weight in bringing about acceptance of this type of legislation. With the forces behind it, this is the very kind of barrier the commerce clause was put in the fundamental law to guard against.

327 U.S. at 434.

States may misinterpret certain language in this Court's decision in *Trinova*, leading them to believe that this Court is now more tolerant of discriminatory state tax provisions if they are intended to promote intrastate business and investment. In *Trinova*, the taxpayer claimed that the fact the Single Business Tax was adopted to encourage Michigan investment was evidence that the tax was unconstitutional. This Court rejected that argument, stating:

> States are free to "structur[e] their tax systems to encourage the growth and development of intrastate commerce and industry." *Boston Stock Exchange, supra*, 429 U.S., at 336-337.

Trinova, ___ U.S. at ___, 111 S.Ct. at 835. The Court did not repeat the next sentence from *Boston Stock Exchange:*

> We hold only that in the process of competition no State may discriminatorily tax the products manufactured or the business operations performed in any other State.

429 U.S. at 337.

As Chief Justice Cavanaugh noted, the quotation from *Trinova* can be misinterpreted as an approval of discriminatory state tax provisions designed to encourage local business. He stated:

> Such sweeping language, if taken out of context and in isolation, would seem to flash a green light to economic protectionism.

Appendix at 36a-37a. The majority adopted just such a misinterpretation in this case.

It is all too likely that other states will follow the lead of the majority when analyzing the permissibility of discriminatory state taxes. The Court should take this opportunity to reconfirm its long standing rule that state tax provisions which encourage intrastate business are constitutional only if the provisions do not discriminate against interstate commerce.

This Court Should Reverse the Michigan Supreme Court and Apply its Decision Retrospectively

Caterpillar submits that the Michigan Supreme Court's decision is in error and the Capital Acquisition Deduction provisions are unconstitutional. If this Court concludes that these provisions are unconstitutional, Caterpillar requests that the Court make it clear that its decision applies retrospectively. While this issue was not addressed by the Michigan Supreme Court, the Court of

Appeals refused retrospective treatment. If this Court reverses and does not address the question of retrospectivity, the result will simply be further litigation on that question in the state courts. Because the question of retrospectivity is a federal question, *American Trucking Associations, Inc. v. Smith*, 496 U.S. 167 (1990), it is appropriate that the Court address the question now.

The Michigan Court of Appeals concluded that the decision finding Capital Acquisition Deduction provisions unconstitutional could apply only prospectively because

> the SBTA "was new and experimental legislation in this state." *Town & Country Dodge, supra*, p 234. We also believe that the method of determining the CAD – especially for personal property – is unique. A similar deduction has never been declared to be unconstitutional.

Appendix at 98a. This conclusion fundamentally misreads the first test of *Chevron Oil*.[10] This is seen most clearly by comparing the Court of Appeals decision with this Court's statements on prospective and retrospective decisions in *U.S. v. Johnson*, 457 U.S. 537 (1982) and in its

---

[10] Prior to the United States Supreme Court's decision in *James B. Beam Distilling Company v. Georgia*, ___ U.S. ___, 111 S.Ct. 2439 (1991), it appeared settled that a decision based on the Constitution could be applied only prospectively if it satisfied the criteria set forth in *Chevron Oil*. However, in *Beam Distilling* five justices explicitly rejected the *Chevron* test or seriously questioned its continued validity. Plurality opinion of Justices Souter and Stevens, ___ U.S. at ___, 111 S.Ct. at 2447, and concurring opinions of Justices Scalia, Marshall and Blackmun, ___ U.S. at ___, 111 S.Ct. at 2450 and 2451. Nonetheless, even under *Chevron* retrospectivity is mandated in this case.

per curiam decision in *Ashland Oil, Inc. v. Caryl*, 497 U.S. 916 (1990).

U.S. v. Johnson involved the question of whether a prior decision of the United States Supreme Court in a criminal case applied retrospectively. The Court stated:

> [W]hen a decision of this Court merely has applied settled precedents to new and different factual situations, no real question has arisen as to whether the later decision should apply retrospectively. In such cases, it has been a foregone conclusion that the rule of the later case applied in earlier cases, because the later decision has not in fact altered that rule in any material way.

457 U.S. at 549. The statement has direct application on the present case. A decision finding the Capital Acquisition Deduction provisions unconstitutional does nothing more than apply settled precedents of Commerce Clause jurisprudence to a new and different factual situation. Thus, retrospective application should be a "foregone conclusion."[11]

This Court's per curiam decision in *Ashland Oil* also counsels in favor of retrospective application. In *Ashland Oil*, the Court gave retrospective application to its decision in *Armco Inc. v. Hardesty*, 467 U.S. 638 (1984), pointing out:

---

[11] The fact that *Johnson* is a criminal case does not detract from its application here. The first test of *Chevron Oil*, whether a decision overrules prior precedent or could not otherwise be anticipated, is the same for civil and criminal cases. Johnson cited *Chevron Oil* and other civil cases as relevant to the determination of whether a decision is a matter of "first impression" or "clearly foreshadowed" by prior law. 457 U.S. at 550, n. 12.

> *Armco* neither overturned established precedent nor decided "an issue of first impression whose resolution was not clearly foreshadowed." *Chevron Oil*, supra, 404 U.S., at 106, 92 S.Ct., at 355. To be sure, *Armco* paved the way for *Tyler Pipe Industries, Inc. v. Washington State Dept. of Revenue*, 483 U.S. 232, 107 S.Ct. 2810, 97 L.Ed.2d 199 (1987), which arguably "overturn[ed] a lengthy list of settled decisions" and "revolutionize[d] the law of state taxation," *Id.*, at 257, 107 S.Ct., at 2825 (Scalia, J., concurring in part and dissenting in part), by extending the internal consistency test. *Armco* itself, however, was not revolutionary.

497 U.S. at ___, 110 S.Ct. at 3205. A decision finding the Capital Acquisition Deduction provisions unconstitutional can hardly be described as "revolutionary". Such a decision overrules no prior decisions of this Court. It simply applies settled law. Thus, retrospective application is both appropriate and necessary.

CONCLUSION

This petition for a writ of certiorari to the Supreme Court of Michigan should be granted.

Respectfully submitted,

RICHARD A. HANSON
Counsel of Record

DON S. HARNACK
GREGORY G. PALMER
CAROL S. PORTMAN
McDERMOTT, WILL & EMERY
227 W. Monroe Street
Chicago, Illinois 60606
(312) 372-2000

Of Counsel
OLIVER OLDMAN
Professor of Law
Harvard University
Langdell Hall
Cambridge, Massachusetts
02138